

REVENUE DEPARTMENT[701]

Adopted and Filed

Pursuant to the authority of Iowa Code sections 17A.3 and 421.14, the Department of Revenue hereby amends Chapter 38, "Administration," Iowa Administrative Code.

The Iowa Code mandates that the Department follow the federal provisions in the determination of innocent spouse relief from state income tax liability. This amendment simplifies the process and criteria the Department considers in granting innocent spouse relief by referring directly to the relevant sections of the federal code and related regulations. Going forward, the Department will presume that a person granted innocent spouse relief for federal tax purposes also qualifies for relief for Iowa tax purposes. In addition, there will be a rebuttable presumption that a person who has not been approved as an innocent spouse for federal tax purposes does not qualify as an innocent spouse for Iowa tax purposes.

Notice of Intended Action was published in the Iowa Administrative Bulletin as **ARC 2299C** on December 9, 2015. Public comments were allowed until 4:30 p.m. on December 29, 2015. No public comments were received on this rule making.

This amendment is identical to that published under Notice of Intended Action.

Any person who believes that the application of the discretionary provisions of these rules would result in hardship or injustice to that person may petition the Department for a waiver of the discretionary provisions, if any, pursuant to rule 701—7.28(17A).

The Department of Revenue adopted this amendment on January 13, 2016.

After analysis and review of this rule making, the Department finds that the changes to this rule are likely to have little or no impact on jobs. The amendment does not substantively change the existing rule but provides clarification and helps to streamline the Department's own internal processes.

This amendment is intended to implement Iowa Code section 422.21(7).

This amendment will become effective March 9, 2016.

The following amendment is adopted.

Amend rule 701—38.15(422) as follows:

701—38.15(422) Relief of innocent spouse for substantial understatement of tax attributable to other spouse. ~~A husband and wife~~ Married taxpayers are generally jointly and severally liable for the total tax, penalty, and interest from a joint return or from a return where ~~they~~ the spouses file separately on the combined return form. However, ~~effective for tax years beginning on or after January 1, 1994,~~ a married person who meets the criteria for an innocent spouse established in Section 6015 of the Internal Revenue Code may be relieved of liability for ~~a substantial~~ an understatement of tax that is attributable to ~~grossly erroneous items of the other spouse.~~ ~~For purposes of determining if an individual is an innocent spouse for state income tax purposes, the provisions in Section 6015 of the Internal Revenue Code will be followed as well as federal court cases, letter rulings, and revenue rulings which deal with innocent spouse.~~ ~~In addition, for tax years beginning on or after January 1, 2002, the provisions of Sections 6015(c) and 6015(f) of the Internal Revenue Code regarding relief for separation of liabilities and equitable relief, respectively, are applicable for Iowa income tax purposes.~~ ~~The following are the criteria that must be considered for purposes of determining if an individual is an innocent spouse for Iowa income tax purposes:~~

1. ~~Understatement of tax attributable to grossly erroneous items of the other spouse.~~ ~~An understatement of the tax is the excess of the tax required to be shown over the tax actually shown on the return.~~ ~~The understatement must be entirely attributable to grossly erroneous items of one spouse in order for the other spouse to be eligible for status as an innocent spouse.~~ ~~As an innocent spouse, the individual will not be liable for the substantial understatement of tax of the other spouse.~~ ~~The tax liability attributable to the understatement is computed by adding penalties and interest that accrued by the date of the deficiency notice.~~ ~~Grossly erroneous items may include any omission from gross income~~

such as income from embezzled funds. Grossly erroneous items may also include deductions or Iowa tax credits that are without factual or legal foundation.

2. **38.15(1) Filing status for return with an innocent spouse.** For state income tax purposes, a married taxpayer filing a return with a spouse can qualify as an innocent spouse only if the taxpayers file a joint return or file separately on the combined return form. A married taxpayer who files a separate state return that has been accepted by the state will not be eligible for innocent spouse status.

38.15(2) Scope of relief for Iowa income tax purposes. An understatement of the tax is the excess of the tax required to be shown over the tax actually shown on the return. An erroneous item is any item resulting in an understatement or deficiency in Iowa taxes to the extent that the item is omitted from, or improperly reported or characterized on, an Iowa tax return, including Iowa deductions and tax credits that would not be included on a federal return.

3.—~~Innocent spouse must establish lack of knowledge of other spouse's substantial understatement. Innocent spouse relief applies only if the individual claiming to be an innocent spouse can establish that in signing the state return, the individual did not know and had no reason to know that there was a substantial understatement of tax. The innocent spouse's lack of knowledge must exist until the time the return is filed and not just until the end of the year (or period) covered by the return. The U.S. Tax Court has provided that the standard for determining if a taxpayer had reason to know of an omission is whether a reasonable person under the particular circumstances at the time of signing the return could be expected to know of the omission.~~

~~In many cases in which innocent spouse relief is sought, the following factors play a role: business background or education of person claiming innocent spouse relief, involvement in family financial affairs by the person claiming innocent spouse relief, involvement in the family business or the transaction giving rise to the understatement by the person claiming innocent spouse relief, whether or not there were lavish or unusual expenditures in the family or increase in standard of living of the family and knowledge of embezzlement activities of the other spouse.~~

4.—~~Whether or not it would be equitable to hold the innocent spouse for the substantial understatement. Innocent spouse relief applies only if, taking into account all facts and circumstances, it would be inequitable to hold the claimed innocent spouse liable for the deficiency in tax for the taxable year attributable to the substantial understatement. Factors taken into account in determining whether it is inequitable to hold a spouse liable for a tax deficiency include whether the spouse seeking relief has been deserted, divorced, separated, or widowed or has been the subject of abuse or financial control by the other spouse. See Internal Revenue Service Notice 2012-8.~~

~~Another important factor in determining equitable treatment for the person claiming innocent spouse relief is whether the person received a benefit attributable to the substantial understatement of taxes. The fact that the spouse received a benefit in the nature of "ordinary support" does not support a finding of significant benefit to deny the spouse relief. In addition, ordinary family support may include maintaining an affluent lifestyle if the standard of living is not enhanced by the tax understatement.~~

~~Where the taxpayer participated in the financial affairs of the other spouse and enjoyed the benefits from the activities of the other spouse, innocent spouse relief will not be granted.~~

38.15(3) Presumption and burden of proof when requesting innocent spouse relief.

a. Presumption. The department shall presume that a final determination letter or other document issued by the Internal Revenue Service approving a request for innocent spouse relief for the relevant tax years shows that the innocent spouse granted relief by that document qualifies for innocent spouse relief for Iowa income tax purposes for those tax years. If the person seeking innocent spouse relief does not provide the department with a final determination letter or other document issued by the Internal Revenue Service approving a request for innocent spouse relief within the time frame set forth in subrule 38.15(4), the department shall presume that the person seeking innocent spouse relief does not meet the criteria to qualify for innocent spouse relief for Iowa income tax purposes and shall deny the request. The burden is on the person seeking innocent spouse relief to rebut this presumption with other evidence.

b. Request without Internal Revenue Service approval. If the department denies a claim for innocent spouse relief, the person seeking innocent spouse relief may protest the department's determination under 701—Chapter 7. The department will evaluate the protest by applying the criteria

set forth in Section 6015 of the Internal Revenue Code and the related regulations. The department will defer to federal court cases, letter rulings, and revenue rulings in interpreting Section 6015 of the Internal Revenue Code and the related regulations. The provisions of Sections 6015(c) and 6015(f) of the Internal Revenue Code regarding relief for separation of liabilities and equitable relief, respectively, are applicable for Iowa income tax purposes for tax years beginning on or after January 1, 2002. The burden is on the person seeking innocent spouse relief to show that the person meets the federal criteria for innocent spouse relief.

5. **38.15(4)** *Time period for requesting innocent spouse relief.* For tax periods beginning on or after January 1, 2004, innocent spouse relief must be requested within two years after the date the department initiates collection action ~~on an income tax deficiency or assessment~~ against the person claiming innocent spouse relief. However, an extended time period to request ~~innocent spouse equitable relief for innocent spouses under Section 6015(f) of the Internal Revenue Code~~ can be granted under the provisions of Internal Revenue Service Notice 2011-70, which became effective July 25, 2011.

This rule is intended to implement Iowa Code section 422.21 as amended by 2002 Iowa Acts, House File 2116.

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EDITOR'S NOTE: For replacement pages for IAC, see IAC Supplement 2/3/16.